Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
2000 Biennial Regulatory Review	)	CC Docket No. 00-175
Separate Affiliate Requirements of Section	)	
64.1903 of the Commission's Rules	)	

COMMENTS OF AT&T CORP.

Pursuant to Rule 1.415 (47 C.F.R. § 1.415) and the Commission's Notice of Proposed Rulemaking, released September 14, 2001 ("*Notice*"), AT&T Corp. ("AT&T") submits these comments on the separate affiliate rules governing the independent incumbent local exchange carriers' ("LECs") provision of in-region, interexchange services. The Commission has repeatedly found that the existing rules are necessary to guard against anticompetitive behavior that would cause substantial public harm, and as shown below, circumstances have not changed in any way that would call into question any of the Commission's prior findings.

As the Commission has repeatedly found, independent incumbent LECs have monopoly control over bottleneck local exchange facilities. *See, e.g., Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, et al.*, CC Docket Nos. 96-149 *et al.*, Second Report and Order, 12 FCC Rcd. 15756, ¶¶ 158-59 (1997) ("*LEC Classification Order*"). "[A]bsent appropriate and effective regulation," independent incumbent LECs therefore "have the ability and incentive to misallocate costs" from their long distance services to their local exchange services, which would "distort price signals" and "cause substantial harm to consumers, competition, and production efficiency." *Id.* ¶ 159. These LECs also "potentially could use [their] market power in the provision of exchange access service to

advantage [their] interexchange affiliate[s] by discriminating against the[ir] affiliate[s'] interexchange competitors" in the provisioning of access. *Id.* ¶ 160. As the Commission has noted, these forms of discrimination would be "difficult to police" because "the level of [LEC] 'cooperation' with unaffiliated interLATA carriers [would be] difficult to quantify." *Id.* ¶ 111.

It is equally clear that, absent regulation, independent incumbent LECs could potentially "initiate a price squeeze," by "rais[ing] the price of access to all interexchange carriers which would cause competing in-region carriers to either raise their retail rates to maintain the same profit margin or reduce their rates" to maintain market share. *Id.* ¶ 161. As the Commission has explained, the LEC could then underprice its interexchange competitors (and, indeed, price its long distance services at or below its access prices), thereby forcing rivals to choose between losing money or losing market share. *Id.* The Commission has recognized that such a scheme could be profitable for the LEC even in the short term, especially to the extent that access charges are already above economic cost, *see id.* ¶¶ 125-28, and could potentially drive competitors from the market altogether, *id.* ¶ 127-28.

To guard against these very real and substantial public interest harms, the Commission has consistently found that independent incumbent LECs' facilities-based interexchange services should be provided through a separate affiliate, with separate facilities, separate books of account, and with the arm's length purchase of the same access services that unaffiliated interexchange carriers purchase from that LEC. *See* 47 C.F.R. § 64.1903; *LEC Classification Order* ¶¶ 162; *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, et al.*, CC Docket Nos. 96-149 *et al.*, Second Order on Reconsideration, 14 FCC Rcd. 10771, ¶ 25 (1999) ("*Second Reconsideration Order*") (service offered on a resale basis may be provided through a corporate division). The Commission has

explained that these requirements "aid in the prevention and detection of such anticompetitive conduct." *LEC Classification Order* ¶ 163. "[S]eparate books of account are necessary to trace and document improper allocations of costs or assets between a LEC and its long-distance affiliate as well as discriminatory conduct." *Id.* The prohibition on jointly owned facilities also combats cost misallocation and "helps deter any discrimination in access" by "requiring the affiliates to follow the same procedures as competing interexchange carriers to obtain access to those facilities." *Id.* Requiring the affiliate to take access at tariffed rates "reduces somewhat the risk of a price squeeze to the extent that an affiliate's long distance prices are required to exceed their costs for tariffed services." *Id.* All of these requirements are necessary to facilitate monitoring and detection of price squeezes (and other harms), which the Commission has indicated could then be dealt with "through our complaint process and enforcement of the antitrust laws," as well as through audits, such as those required for Bell Operating Companies under Section 272(d) of the Act (47 U.S.C. § 272(d)). *Id.* ¶¶ 128, 171.

There is no possible basis for relaxing these requirements. The independent incumbent LECs' ability to inflict anticompetitive harms stems solely from their control over bottleneck local exchange facilities, and they fully retain those bottleneck monopolies today. The Commission strongly reiterated just two years ago that independent incumbent LECs "can cause substantial harm to consumers and competition, by virtue of their control of bottleneck facilities," and that "*only* the emergence of competition in the local exchange and exchange access markets will eliminate independent LECs' ability and incentive to engage in anticompetitive activity." *Second Reconsideration Order* ¶ 14 (emphasis added); *see also LEC Classification Order* ¶ 196. The competitive landscape is not materially different today than it was two years ago; indeed, there has been virtually no competitive entry in the independents'

territories. Because there has been no relevant change since 1999, there is no basis for changing the rules governing the independent LECs' provision of in-region interexchange services.

If anything, recent circumstances confirm that the Commission's separate affiliate safeguards are still necessary. For example, publicly available information strongly suggests that SBC's long distance affiliate is pricing its long distance services at rates that do not cover the affiliate's costs. SBC maintains intrastate access rates in Texas of nearly six cents per minute (originating plus terminating). SBC's long distance affiliate, however, offers long distance rates in Texas as low as five cents per minute, as well as a block of 100 minutes for six dollars (*i.e.*, six cents per minute). Given that SBC's affiliate also undoubtedly has significant and often publicly identifiable[1] costs for marketing, billing and collection, overhead, interLATA transport, and other expenses, it is highly likely that SBC's long distance affiliate is operating at a loss on a consistent basis.

The results of SBC's pricing behavior have been dramatic. On March 1, 2001, SBC announced that its affiliate had won 2 million subscribers in Texas. *See* SBC Investor Briefing, No. 224 (March 1, 2001). Considering that SBC's total customer base in Texas is 10 million, SBC's affiliate achieved a 20 percent market share in less than eight *months*. By comparison, it took Worldcom from 1984 to 1999 to gain approximately 18 percent in long distance market share.[2] SBC recently announced that, as of the end of the third quarter, its affiliate had won 4.6 million customers across the four states in which it has long distance authority, up from 2.3 million a year ago. *See* SBC Investor Briefing No. 227 (October 22, 2001). This represents not only a 100 percent increase in the number of lines subscribed to SBC long distance service, but

[1] Through publicly disclosed Affiliate Transaction contracts.
[2] Statistics of the Long Distance Telecommunications Industry, January 2001.

also approximately 32 percent of all switched access lines in service in those same four SBC states. *See* FCC ARMIS 43-08 data, year end 2000 (total switched access lines).

Independent LECs also appear to be engaged in a price squeeze. For example, Verizon in Missouri offers intrastate long distance service through its long distance affiliate at a price of 11 cents per minute, and Verizon's local affiliate offers intraLATA toll service for 9 cents per minute.[3] Yet, Verizon charges 7.15 cents per minute to originate long distance traffic and the approximate cost to terminate long distance traffic in Missouri is 7.5 cents per minute. It is obvious, from access rates alone, that Verizon is pricing its long distance services substantially below cost.

Thus, these and other LECs may be engaged in a classic unlawful price squeeze. As the Commission has made clear, "[a] BOC interLATA affiliate that charges a rate for its interLATA services below its incremental cost to provide service would be in violation of Sections 201 and 202 of the Communications Act, if such a rate were sustained over a period of time." *LEC Classification Order* ¶ 128. Separate affiliate safeguards like those at issue here would be indispensable in determining whether independent LECs are in fact engaged in an unlawful price squeeze. If anything, the current rules should be strengthened to require all incumbent LECs to report separately the financial results of their long distance affiliates, so that regulators and other interested parties can more easily determine whether the affiliates' long distance prices exceed their costs.

Alternative safeguards, such as permitting LECs to offer these services through a "corporate division," as in the *Second Reconsideration Order*, would be wholly ineffective. *See, e.g., Notice* ¶¶ 16-17. Allowing the incumbent LEC to own and operate both local exchange and

[3] *See* www2.verizonld.com/residential/plan_smarttouch.jsp.

interLATA facilities would fatally undermine the protections offered by the current rules. Most obviously, such a "corporate division" rule would vastly increase the ability of a LEC to engage in discrimination in the provisioning of access services. *See LEC Classification Order* ¶ 163. Allowing co-ownership of facilities would also increase the ability of LECs to engage in price squeezes and cost misallocation, by making it far more difficult for regulators to identify the long distance operations' costs.

None of the other "changed circumstances" on which the Commission seeks comment would justify relaxation of the existing separate affiliate rules. For example, Section 254(g)'s rate averaging requirements if anything heighten the ability of regional carriers like the independent LECs to engage in effective price squeezes. National carriers experience extraordinary variations in access rates across the country, and are effectively forced to charge nationwide end-user rates for interstate traffic that reflect a blended average of those varying access charges. Regional carriers like the independent LECs can charge above-cost access rates that are above this blended average, while matching (or bettering) the national carriers' nationwide long distance rates. Indeed, as explained above, that is precisely what SBC does in Texas. The uneconomic price signals caused by Section 254(g)'s rate averaging requirements thus have two effects. First, no unaffiliated regional carrier could possibly pay the incumbent LEC's high, in-region access charges and compete with the incumbent's long distance affiliate; entry on a regional basis is essentially foreclosed. And the LEC's high access charges eat into the national carriers' profit margins, while the incumbent LEC makes dramatic gains in market share. *Cf. LEC Classification Order* ¶ 127.

Moreover, the impending adoption of portions of the Multi-Association Group (MAG) Plan would not affect the ability of independent LECs to engage in anticompetitive behavior.

Notice ¶ 20. Although the MAG Plan would reduce traffic sensitive access charges, the MAG Plan's rate levels would still be well above economic cost, and thus facilitate price squeezes. Similarly, participation in the National Exchange Carrier Association (NECA) access charge pool does not result in cost-based access charges (*Notice* ¶ 20); the Commission has repeatedly found that independent LECs have the ability to engage in anticompetitive behavior notwithstanding the fact that independent LECs have participated in NECA pools for years. *See, e.g., Second Reconsideration Order* ¶ 14. As the Commission has found, "*only* the emergence of competition in the local exchange and exchange access markets will eliminate independent LECs' ability and incentive to engage in anticompetitive activity." *Id.* (emphasis added)

Finally, the need to monitor and detect the substantial public interest harms that result from price squeezes and other anticompetitive conduct greatly outweighs the modest costs necessary to maintain a separate affiliate. The Commission has previously found that the regulatory burdens imposed by the separate affiliate rules "are not unreasonable in light of the benefits these requirements yield in terms of protection against improper cost allocation, unlawful discrimination, and price squeezes." *LEC Classification Order* ¶ 167. There have been no relevant changes since those findings: independent LECs have an undiminished ability to engage in such anticompetitive practices, and the potential harms from those practices, which are unchanged, continue to outweigh the costs of a separate affiliate, which are also unchanged. Indeed, the Commission was overly generous in 1999 when it relaxed the rules to permit independent LECs to offer interexchange services on a resale basis through a corporate division, rather than through a separate affiliate. *See Second Reconsideration Order* ¶ 25. There are no grounds for relaxing those rules any further.

CONCLUSION

The Commission should retain the existing separate affiliate rules governing independent incumbent LECs' provision of in-region interexchange services, and if anything, it should strengthen those rules to require more complete disclosure of the affiliate's separate financial results.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 1st day of November, 2001, I caused true and correct copies of the forgoing Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: November 1, 2001
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